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THE INCREASE OF INHERITANCE TAXES IN NEW YORK.

The amount raised for the support of the state government in New York is now more than seven times what it was in 1886. This cannot be accounted for by the increase of population, for the population of the State has increased only about eighty per cent. while the state expenses have been increasing seven hundred per cent. We are spending more per capita on our state government than we did, and, in studying the high cost of living, we must now reckon this as one of our extravagances. As a matter of ways and means, it is evident that the State has found new ways of spending money, and it is equally evident that it must have found new means for raising revenue.

Looking, then, at the receipts of the state government, it appears that the largest single source of income is now the inheritance tax, and that the increase in this tax is more notable even than the increase in state expenditure. In 1886, the tax yielded less than $85,000, while in 1912 it yielded over $12,000,000.

This increase in the amount received from one tax is worthy of study for many reasons—The period since 1886 covers the entire history of this tax in New York, for it began with a statute passed in 1885; also New York has, to a certain extent, set the pace for other States, for since 1886, 31 States have adopted the inheritance tax as a means of raising revenue. So we may here study the attitude of American communities toward a new tax, and this is worth while, for we live in a time of new taxes and of the new use of old taxes. And, it is well to note the attitude of the average American legislator toward this tax, for the temptations to extend it have been strong and insidious. It is an exaction dear to the hearts of many legislators because the large body of voters do not have to pay it. It falls chiefly on the prosperous, and falls on them at a time when they are able, and, perhaps, willing to pay. This may account for the fact that in the past 27 years the New York legislature has passed more than 80 statutes relating to inheritance taxation, or an average of about three statutes a year. Many of these acts have related to minor administrative features, but some have made important, even radical, changes.

The increase in the amounts yielded annually by the tax has

been caused not so much by the raising of rates, as by repeatedly extending the tax to cover new interests in property, and by trying to go to, and even beyond, constitutional limits, in order to reach trust estates from the past still awaiting final division. Few taxes have ever given rise to more litigation, and decisions by the hundreds lie in strata in our court reports, each stratum based more or less on the tax statute of a certain year, yet most of them connected in a way with the general development of this form of taxation. The vast labor devoted to these litigations has been well bestowed, for without it, unjust provisions would have discredited our laws and dangerous experiments would have grown into institutions. Legislators and state officers on the one hand have worked generally to extend the tax, while the citizens who were subjected to this special burden have set in motion the restraining force. And so it has happened, as it often happens, that an institution has been kept in its proper place, like the earth on which we live, by a balance of contending forces.

The first New York statute[1] on the subject imposed a tax only where property passed by will or by the intestate laws to collateral relatives or strangers. The rate of the tax was five per cent., and that is the same rate still prevailing where collaterals or strangers take, except that we have now adopted, in a qualified way, the principle of a progressive tax and so have made the law teach that increasing wealth involves increasing burdens by making this rate increase to six, seven and eight per cent., as the amounts involved increase.

This first Collateral Inheritance Tax was promptly attacked on constitutional grounds in the state and federal courts,[2] and in both jurisdictions the attack failed. This was to have been expected, for the tax had been known in Europe for centuries and was not unknown on this side of the Atlantic. The federal government had resorted to it in 1797[3] and again during the Civil War and seven of the States had adopted it, or, at least, had experimented with it, before 1885. And, in connection with those earlier statutes, the important constitutional questions involved had already been passed upon by the courts.

[1]Laws of 1885, c. 483.

[2]Matter of McPherson (1887) 104 N. Y. 306; Wallace *v.* Myers (C. C. 1889) 38 Fed 184.

[3]Laws of 1797, c. 11.

But the scope and machinery of the New York act were partly new, and at one important point the machinery soon broke down. The act applied not only to the property of resident decedents, but also, in a dim way, it tried to reach all property which "shall be within this state." It was held, however, in the *Enston* case[4] that this did not extend to property in this State which passed by will or intestacy from a non-resident decedent. At once there commenced one of the efforts of the State to enlarge the scope of the act, and, while the *Enston* case was still before the courts, the legislature adopted the Act of 1887[5] which explicitly imposed a tax on property within the State which belonged to a non-resident decedent.

This new act of 1887 promptly raised a series of questions; among them—whether the principle still applied that the situs of personal property followed the residence of the owner. The *Romaine* case[6] decided that the fiction of law that personal estate has no situs away from the person or residence of its owner was done away with, to a limited extent and for a specified purpose, by the Act of 1887, and that property invested, or habitually kept by a non-resident, in New York was liable for the tax.

Taking up, then, the question of what must be considered as "property within the state," the Court of Appeals, in a series of decisions announced in 1896,[7] went on to hold that bonds of New York corporations, kept by a non-resident out of the State, were not subject to this tax in the event of his death, but that stocks of New York corporations kept by him in the same way were; that bonds of both domestic and foreign corporations, if kept in New York by a non-resident, were taxable, and that his funds on deposit with a New York trust company were also taxable.

And then, again, the machinery of the act broke down. The Act of 1887 was assailed on constitutional grounds in the *Embury* case[8] because where it was sought to apply the act to the estates of such non-residents as did not happen to own real estate in New York, the act did not empower any tribunal to fix the tax on notice to the owner. This objection prevailed and non-resi-

[4](1889) 113 N. Y. 174.

[5]Laws of 1887, c. 713.

[6](1891) 127 N. Y. 80.

[7]Matter of Bronson (1896) 150 N. Y. 1; Matter of Whiting (1896) 150 N. Y. 27; Matter of Hondayer (1896) 150 N. Y. 37.

[8](1897) 154 N. Y. 746.

dent estates were freed from the tax under that statute, except in cases where such estates happened to include lands in New York.

During this period of debate about the property of non-residents, the State was also seeking to extend the tax so as to reach trust estates and remainders which had been created before the tax existed, but which had not yet been fully divided. To understand the sequence of these steps it is necessary to note that an important change had been made in the tax in 1891,[9] when it was extended to reach property passing to direct descendants, so that, above a certain exempted minimum, all property passing by will or intestacy was subject to the tax. Up to that point the legislature had been amending the original Collateral Inheritance Tax Law of 1885, but now that the tax had been extended to inheritances generally a new and more elaborate statute was passed—the Transfer Tax Act of 1892.[10] Much of the Transfer Tax Act related to the procedure as to which earlier acts had been silent, but it attempted to make some important substantive changes, and one of these was by the addition of a clause which imposed a tax when any person "becomes beneficially entitled, in possession or expectancy, to any property or the income thereof by any such transfer, whether made before or after the passage of this act." This purported to reach remainders then existing, even where the remainder had vested before any tax of this sort was known in the State. The lower courts sustained the State in this effort, but the Court of Appeals reversed them,[11] and so ended the effort of the State in that particular direction. And, later on, in the *Pettit* case[12] the courts refused to give a retroactive effect to the law by deciding that there was no tax in cases where undivided property of a non-resident decedent, which had not been subject to the tax when he died, remained in New York until after the tax law was adopted.

Failing in this, the State then sought to collect a tax in cases where a power of appointment created before the tax existed was exercised after the tax law was adopted. This effort also failed[13] on the familiar principle that the act of the donee of such a power is the act of the creator of the power. But again while

[9]Laws of 1891, c. 215.

[10]Laws of 1892, c. 399.

[11]Matter of Seaman (1895) 147 N. Y. 69; Matter of Pell (1902) 171 N. Y. 48.

[12](1902) 171 N. Y. 654.

[13]Matter of Harbeck (1900) 161 N. Y. 211.

this litigation was in progress, and even before the Court of Appeals had rendered its final decision, the legislature proceeded to change the statute on this subject by passing the "Amendment of 1897,"[14] which provided that whenever a person

"shall exercise a power of appointment derived from any disposition of property made either before or after the passage of this act, such appointment when made shall be deemed a transfer taxable under the provisions of this act in the same manner as though the property to which such appointment relates belonged absolutely to the donee of such power and had been bequeathed or devised by such donee by will."

This was taxation by hypothesis. It was an application to serious affairs of the method a child adopts when he plays he is somebody else. And the hypothesis was resorted to to avoid some serious constitutional limitations. But, in the *Vanderbilt* case,[15] in the *Dows* case,[16] and in the *Delano* case[17] the State prevailed. In these cases the power had been exercised by the will of the donee of the power, and the underlying theory of the cases, as stated by the Court of Appeals in the last one, was that "the privilege of making a will is not a natural or inherent right, but one which the state can grant or withhold in its discretion. If granted, it may be upon such conditions and with such limitations as the legislature sees fit to create."

These rulings on the subject of appointments were somewhat limited by a line of cases beginning with the *Lansing* case[18] where it was held that if the appointee under the power would have taken the same property in default of the exercise of the power, that is, where he was not bound to rely on the exercise of the power for his title, there would be no tax. And it was also held that if the State was going to play that the donee of the power was the owner of the property which he appointed, the State must play fair, so that, if the property when regarded as belonging to the donee was not within reach of the tax, no tax could be imposed.

Up to 1903, real estate was not subject to the tax unless it passed to collaterals or strangers, but a statute of that year[19]

[14] Laws of 1897, c. 284.

[15] (1900) 163 N. Y. 597.

[16] (1901) 167 N. Y. 227; Orr *v.* Gilman (1902) 183 U. S. 278.

[17] (1903) 176 N. Y. 486; Chanler *v.* Kelsey (1907) 205 U. S. 466.

[18] (1905) 182 N. Y. 238.

[19] Laws of 1903, c. 41.

made an important change and imposed a tax on real estate passing to direct descendants. As thus changed, we find the tax imposed on both real and personal property and reaching all who could take by will or descent, except certain charitable and religious corporations which were exempted.

Up to this point the tax had grown in a natural way, and in the form which it had then reached it remained substantially unchanged for some years. But influences were in the air tending to a ranker and more dangerous growth. In the spring of 1906, Mr. Roosevelt, being then President, and on the occasion of laying the cornerstone of the Office Building for the House of Representatives, delivered a speech relating to a number of subjects. One of the subjects was inheritance taxation. As to this he said that he felt that we should ultimately have to consider the adoption of some such scheme as that a progressive tax shall be imposed on all fortunes beyond a certain amount, either given in life or devised or bequeathed upon death to any individual, a tax so framed as to put it out of the power of the owner of one of these enormous fortunes to hand on more than a certain amount to any one individual; the tax, of course, to be imposed by the national, and not the state, government.

And in the message which Mr. Roosevelt sent to Congress in the following December, he again discussed this subject and said:

"I feel that in the near future our national legislators should enact a law providing for a graduated inheritance tax by which a steadily increasing rate of duty should be put upon all moneys or other valuables coming by gift, bequest, or devise to any individual or corporation. It may be well to make the tax heavy in proportion as the individual benefited is remote of kin. In any event, in my judgment the pro rata of the tax should increase very heavily with the increase of the amount left to any one individual after a certain point has been reached."

This advice was primarily addressed to Congress, but it related to a subject in which the state governments were more immediately interested, for, while inheritance taxes had occasionally been imposed by the federal government at times of special need, they had become a permanent and important source of revenue for most of the state governments. It was, therefore, to be expected that the first fruits of this suggestion would appear in state statutes, and it is not surprising that the legislature of Oklahoma proceeded in the following year to adopt an inheritance tax law[20] which fol-

[20]Laws of Oklahoma (1907-1908) c. 81.

lowed closely the presidential recommendation that "the pro rata of the tax should increase very heavily with the increase of the amount left to any one individual * * *."

The primary rates of this Oklahoma tax varied from one per cent. where the person benefited was a wife, husband or descendant, to five per cent. where collaterals or strangers took. But these primary rates only applied to relatively small sums, and, as the amounts involved increased and the relationship became more remote, the tax increased at a rate which strains both the mathematical faculties and the imagination. For example: It was provided that where collaterals took "upon all in excess of Five hundred dollars * * * the primary rate provided for herein shall be increased one-tenth of one per cent. for every one hundred dollars increase in valuation for such excess."

Under this phraseology an inheritance of $100,000. passing to a collateral relative would seem to involve a tax of at least $100,000., and, if he were so unfortunate as to have $200,000. left to him, apparently he would have to pay a tax of $400,000. on the legacy. The English language becomes a dangerous weapon in the hand of one who is thoroughly alive to the misdeeds of a class to which he does not belong. Also, this statute prompts the reflection that it is a dangerous thing to invest, or die, in Oklahoma.

Two years later New York responded to the same influence, although it did not go as far as Oklahoma. The New York statute of 1910[21] made the rate of the inheritance tax progressive. In cases where a wife, husband or descendant took, the rate commenced at one per cent. and increased to five per cent. as the amounts increased, and, in the case of collaterals or strangers, the rate commenced at five per cent. and went up to twenty-five per cent.

As we have seen, the New York courts had decided in the case of non-resident decedents that all bonds kept in the State, most bank deposits, and the stocks of all New York corporations wherever kept were subject to this tax. This Act of 1910, with its high progressive rates, bore heavily enough upon the citizens of the State who were constructively represented by the legislature which had passed the act. But the burden was much harder to be borne by the non-residents who were in no way responsible for the act and yet who had been invited to invest their funds in this State or to keep them here. Considering the position of New

[21] Laws of 1910, c. 706.

York as related to the financial transactions of the country and of the world, the Act of 1910 was quite an effective statute for the suppression of business activity. It is easy to frighten away capital where a legislature violates the rules of fair dealing, and, in this case, capital from out of the State did what was to be expected. It left. A rough estimate made by the banking interests indicated that more than four hundred million dollars were promptly withdrawn from the State. It was estimated that between six thousand and seventy-five hundred safe deposit boxes in New York were given up. But the act did not yield the expected revenue. It was confiscation, but it failed to confiscate. The State awoke to its folly and after an evil and disastrous life of twelve months the Act of 1910 was repealed and there was passed the Act of 1911,[22] which is in many respects a credit to the State. Progressive rates were retained, but in the case of descendants these rates ran up only to four per cent. and that rate only applied to sums over a million dollars, and, in the case of collaterals and strangers, the rates, starting at five per cent. ran up only to eight per cent.

Another change was made of hardly less importance as indicating a returning sense of justice. It was provided by the Act of 1911 that in the case of non-resident decedents the tax applied only to tangible property within this State and that the stocks of New York corporations and the bonds or deposits kept in this State by non-residents were not subject to the tax. It had again become safe for non-resident investors to trust New York.

This last step of New York was in the direction of ending the scandal of double taxation. Of late years there has been a somewhat discreditable scramble between the States in this regard and it might well have been said in the United States that nothing in a man's life became him so much as the leaving of it within the borders of a just jurisdiction, at least so far as the interests of his family were concerned. Where a decedent has had investments outside of his own State, his family generally had to pay an inheritance tax on them in addition to the tax on the entire estate imposed in the home jurisdiction. If the courts of two States did not agree as to what the legal residence of the decedent had been, there was also double taxation growing out of the question of residence. We have not been called upon to contend over the birthplace of deceased poets, but if one should die in the United States and should happen to leave anything several States would probably contend for the opportunity of taxing it. And then we

[22] Laws of 1911, c. 732.

may have a federal inheritance tax that will apply to the whole estate in addition to these state taxes. Anything unfair in this tax may, therefore, be multiplied several times, and so there are few subjects of statute law which call for more moderation and sense of fairness than this one which relates to inheritance taxation.

Sharp conflicts between old formulas and present realities have arisen as this tax has grown. Some of these have been settled, but the most important of all seems to be just beginning in a serious way. In the litigations growing out of the discriminations in the tax and out of efforts to tax property interests supposed to be exempt, it has repeatedly been held that the tax was not subject to the constitutional limitations invoked because the inheritance tax law was, theoretically, an amendment to the Statute of Wills and the Statute of Descent; that it was in the power of the State to give or to withhold the right to make a will or the right to take by descent, and, therefore, that it was within the power of the State to impose any conditions it thought proper on the making of wills or on the passing of property by descent. That is, to take as much of the estate for itself as the legislature might think proper.

This makes the so-called inheritance tax not really a tax but the withholding of a privilege. It is not necessary to pursue this doctrine to extremes and to inquire whether the State may deny altogether the right to make wills and the right to inherit. It is enough to note that, in applying this tax, the citizen has been denied the protection of the Constitution with respect to unjust discriminations on a theory which rests on the proposition that the right to make wills or to inherit are not natural rights in the modern State, but must be given, and may be withdrawn, by statute. The New York Court of Appeals has held that this is the only theory on which the tax could be upheld in respect to some of its discriminations and in some of the cases where it has been imposed on property supposed to be exempt.

Notwithstanding the formidable line of authorities in this country sustaining the proposition that the right to make wills or to take by descent are not natural rights, a tone of personal dissent may be detected in the opinions of some of the judges best qualified to speak with authority,[23] and this has appeared in opin-

[23]For example, see opinion of Vann, J., in Matter of Lansing (1905) 182 N. Y. 238, 249, where he said: "The theory of a transfer tax is that it is a tax on the right accorded to take under a will or to succeed in cases of intestacy which, *it is said in the decisions,* are privileges, that may be accorded or denied by the state." (Italics mine.)

ions in which this preponderance of authority has been followed. But a direct conflict of authority has recently appeared. The Supreme Court of Wisconsin[24] has faced this question and has held that the right to make wills or to take by descent are natural rights of the citizen of the modern State, and within a few months past one of the Surrogates of New York County, in an opinion[25] discussing the question has cited a number of the great legal authorities of Europe in support of the conclusion, that the right to dispose of property after death is a natural and inherent right of mankind which cannot be taken away by statute.

The present danger in this country is not that a State may seek to directly take away the power to inherit or to make wills. Public opinion makes so extreme an application of this doctrine impossible. But, as the law now stands in most of the States of the United States, the legislatures may proceed to extend inheritance taxes, unrestrained by constitutional limitations, on the legal theory that the State is dealing merely with privileges of the citizen and not with his rights, and that it may withdraw those privileges whenever it sees fit. The average citizen does not understand what the legal powers are, which are being used by the legislature in these acts, and does not appreciate that the legislature is using on an extended and extending scale, a power of appropriating private property which public opinion would not tolerate if the power were used openly and directly. The danger is not remote. Three years ago, as we have seen, the New York legislature passed an act under which twenty-five per cent. of some estates was taken. This was done at a time when Congress had recently been urged by a President to pass a similar federal inheritance tax, and if Congress had adopted the recommendation contained in the President's message of December, 1906, and had passed an act like the New York Act of 1910, we should have had statutes under which about fifty per cent. of some estates would have passed to the state and federal governments on the death of the owner. Whether the owners of such estates, or their property, would continue within our borders under such laws is another question. But the danger of our being saddled with unfair laws and economic disaster was, and is, a real one.

We have seen the growth of this tax in New York, and we may now be approaching a federal inheritance tax. The law on

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[24]Nunnemacher *v.* State (1906) 129 Wis. 190.

[25]Surrogate Fowler in *In re* Gedney's Will (1913) 142 N. Y. Supp. 157.

this subject is important now and grows more important, yet in most States and in the federal courts the citizen is not protected by the usual constitutional limitations on the taxing power of the government. Does this theory, on which most of our courts depend, that the State may at its pleasure give or withhold the right to take by will or descent—does this represent a present reality, or are we holding on to an old formula which ought not now to be applied in our form of government and under modern conditions? This question leads us close to the foundations of the institution of private property. Many men—probably most men with families—work not so much for themselves as for their families. It is to the interest of the State that they should do this. Such men are citizens of the best sort. If, then, the modern government denies to the family the benefit of the property so accumulated, it will discourage the man who worked for the property about as much as if his possessions were taken directly from him. Among civilized peoples, governments cannot now take the property of a citizen, except for imperative public needs or after paying for it. Is it more civilized to take from his family the property he has worked for, and, by doing this, to strike his motive for industry at its tender point?

Where our courts have decided that the rights to inherit and to make wills were not natural rights of the citizen, that decision has rested on the formula that, where an owner of property dies, the sovereign (now the sovereign State) succeeds to the ownership of his property, and that individuals cannot take that property by will or descent unless the sovereign chooses to forego his (its) right. This formula has a flavor of antiquity and of monarchy. Obviously, it originated in the centuries when monarchs were not restrained by constitutions and it applied to personal sovereigns, with all their ideas of divine right, ultimate ownership of property, and the like. The formula is a survival of a period when institutions did not depend on the consent of the governed. It is framed in the interest of the sovereign rather than in the interest of the citizen, and it is improbable that it ever had the consent of the governed except in the sense that they submitted to it. The question whether or not it is to become a permanent part of our laws here in the United States is an important one—too important to be decided by anything less than the deliberate verdict of the people. It is important enough to have a place in our constitutions, if this is to be the rule as between the American state and the

American citizen. When the state and federal constitutions were adopted in this country, the citizens had property, and, in framing those constitutions, they gave the state and federal governments power to deal with that property to a certain limited extent, but they have not given to either government the right to take property on the death of its owner. American citizens have been careful to limit governments in matters of much less consequence.

But formal action by the people is not necessary, if our courts can become satisfied that this formula is not suited to modern theories of the rights of American citizens. In some cases the formulas of monarchy have been taken over in this country where it has been useful or convenient to do so. But where they have been unsuited to present conditions, modern courts have abandoned the ancient formula and proceeded to deal with the present fact.

In less important particulars, the courts of the United States have abandoned old formulas in developing this tax. For example: The old and familiar maxim under which personal property was held to be located at the residence of its owner, came in conflict with the fact that the property of non-residents requires police and fire protection and the aid of courts and government departments as much as the property of residents, and, that, in the nature of things, it ought to share the expenses of government with the property of residents. And in deciding not to follow the old maxim the Supreme Court of the United States observed that "when logic and the policy of a state conflict with a fiction due to historical tradition, the fiction must give way."[26]

The inheritance tax is not only called a tax, it is understood by the people generally to be a tax and not the withdrawal of a privilege, and probably not one citizen in a hundred knows anything about this ancient formula or knows that the legislature by means of it is going on to take over increasing amounts of private property unrestrained by the usual constitutional checks. If this tax is given the legal status of a tax instead of being regarded as the withdrawal of a privilege we may have the usual constitutional safeguards against improper legislation. And this tax will, to that extent, cease to be an instrument for creating those discriminations which first separate the interests of classes and ultimately tend to separate the classes themselves.

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[26]Blackstone *v.* Miller (1903) 188 U. S. 189, 206.